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# **In the Supreme Court of the United States**

OCTOBER TERM, 1948

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No. 724

KOHINOOR COAL COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS FOR THE  
THIRD CIRCUIT*

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**BRIEF FOR THE RESPONDENT IN OPPOSITION**

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## **OPINIONS BELOW**

The opinion of the Tax Court (R. 8-9) is a memorandum opinion and therefore not officially reported. The opinion of the Court of Appeals (R. 80-90) is reported in 171 F. 2d 880.

## **JURISDICTION**

The judgment of the Court of Appeals was entered on December 20, 1948. (R. 90). A petition for rehearing was denied on January 13, 1949. (R. 105). The petition for a writ of certiorari was filed on April 13, 1949. The jurisdiction of this Court is properly invoked <sup>1</sup> under 28 U.S.C., Section 1254.

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<sup>1</sup> The taxpayer is in error in stating that the jurisdiction of this Court is invoked under 28 U.S.C., Section 344 (b). (Pet. 4.)

**QUESTION PRESENTED**

Whether the taxpayer as lessee of culm or refuse banks of an anthracite coal mine is entitled to a deduction for depletion under Section 23 (m) of the Internal Revenue Code.

**STATUTE AND REGULATIONS INVOLVED**

The statute and regulations involved are set forth in the Appendix, *infra*, pp. 9-12.

**STATEMENT**

The facts, which were stipulated (R. 10-37), and as found by the Tax Court (R. 8-9) are substantially as follows:

The taxpayer, a Pennsylvania corporation, filed its returns for the years in question with the Collector of Internal Revenue for the Twelfth District of Pennsylvania. (R. 8.)

The taxpayer entered into an agreement with Turkey Run Fuels, Inc., on February 11, 1941, whereby it leased from Turkey Run, the owner, culm or refuse banks of material which Turkey Run had theretofore thrown aside in the operation of its anthracite coal mines. The lease was to run for ten years or a shorter period if the marketable coal was exhausted from the refuse piles sooner. The taxpayer was to pay an annual rental of \$24,000 and was granted the right to remove all coal from the refuse piles. It also agreed to pay all taxes on improvements and on the coal shipped, but not on the lands. The taxpayer erected various buildings and installed machinery and equipment

and began operations. It extracted coal from the refuse piles pursuant to the lease during the taxable years. (R. 8-9.)

In its return for the fiscal year ended June 30, 1943, the taxpayer computed depletion on a percentage basis, and claimed a deduction of about \$22,000 (R. 12); in its return for the fiscal year ended June 30, 1944, the taxpayer elected to take depletion on a percentage basis, but did not claim the deduction because the question was being contested by the taxpayer for earlier years (R. 13, 60). After the Commissioner disallowed the deduction for depletion for the taxable year ended June 30, 1943, and determined a deficiency upon other grounds for the fiscal year ended June 30, 1944 (R. 6), the taxpayer filed a petition for review of the Commissioner's determination with the Tax Court covering both years (R. 2-6).<sup>2</sup>

The Tax Court decided that the taxpayer was not entitled to a deduction for depletion (R. 8-9) and the Court of Appeals affirmed that decision (R. 80-90).

#### ARGUMENT

The Court of Appeals was clearly correct in denying to the taxpayer an allowance for depletion with respect to its extraction and processing of coal from culm or refuse banks which it had leased

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<sup>2</sup> Since the taxpayer did not claim the deduction for depletion in its return for the year ended June 30, 1944, that year involves an overpayment. See Section 322 (d) of the Internal Revenue Code (26 U.S.C. 1946 ed., Sec. 322).

for that purpose from another taxpayer which owned and operated the coal mine. The deduction for depletion permitted by Section 23(m) of the Internal Revenue Code (Appendix, *infra*) is, so far as here relevant, limited to "mines . . . and . . . other natural deposits," and provides that the allowance for depletion is "in all cases to be made under rules and regulations to be prescribed by the Commissioner." Section 29.23(m)-1 of Treasury Regulations 111 (Appendix, *infra*) provides in pertinent part that "the owner of an economic interest in mineral deposits" is allowed depletion deductions. A "mineral deposit" is defined as "minerals in place."<sup>3</sup> A culm bank is clearly not a "natural deposit" or "minerals in place."

The rationale of the statute and the regulation is not obscure. A "mineral deposit in place" represents a reservoir of capital investment of one who either owns such deposit or who has such an "economic interest" in it as to amount to a capital investment. His capital investment is depleted as the natural deposit is depleted. In such a case, the mineral deposit in place is recognized as a wasting asset of the taxpayer, and the depletion allowance is intended as a compensation for the part of his capital used up in production. See

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<sup>3</sup> The Regulations, unless in conflict with the statute, have the force of law. *Maryland Casualty Co. v. United States*, 251 U.S. 342, 349; *Manhattan Co. v. Commissioner*, 297 U.S. 129, 134; *Douglas v. Commissioner*, 322 U.S. 275, 280. The taxpayer does not contend that there is such a conflict.

*Kirby Petroleum Co. v. Commissioner*, 326 U. S. 599, 602-4.

It is plain that this rationale has no application to a taxpayer in the situation of the Kohinoor Company. It has no ownership, no capital investment and no economic interest of any description in the mineral deposit in place which suffered depletion—*i.e.*, the coal mine owned by Turkey Run Fuels. The courts have repeatedly recognized that the deduction to compensate for the depletion of a capital investment in a natural resource was never intended to be granted to a taxpayer who is merely processing the output of a mine owned and operated by another taxpayer. *Helvering v. Bankline Oil Co.*, 303 U. S. 362, 367; *Consolidated Chol. G. & S. M. Co. v. Commissioner*, 133 F. 2d 440 (C. A. 9); *Atlas Milling Co. v. Jones*, 115 F. 2d 61 (C. A. 10), rehearing denied, 115 F. 2d 64, certiorari denied, 312 U. S. 686; *Chicago Mines Co. v. Commissioner*, 164 F. 2d 785 (C. A. 10), certiorari denied, 333 U. S. 881. Kohinoor, as the Tax Court pointed out, "is recovering all of its actual costs through deductions for the rent under the lease, for depreciation of its physical equipment, and for its costs of operation. \* \* \* there would be no reason to suppose that Congress intended a taxpayer like this one to have a deduction for depletion in view of the fact that it never had any cost to recover." (R. 9).

The cases which the petitioner cites as being in conflict with the decision of the Court of Appeals

are plainly distinguishable. Most of them involved taxpayers who owned the mine or other natural deposit in question. *Herring v. Commissioner*, 293 U. S. 322; *Douglas v. Commissioner*, 322 U. S. 275; *Kirby Petroleum Co. v. Commissioner*, 326 U. S. 599; *Commissioner v. Kennedy Min. & M. Co.*, 125 F. 2d 399 (C. A. 9); *New Idria Quicksilver Min. Co. v. Commissioner*, 144 F. 2d 918 (C. A. 9). The other two are simply holdings that lessees of a mine and an oil well, respectively, who were engaged in extracting the minerals from their natural deposits, had in the particular circumstances of each case such an "economic interest" in mineral deposits in place as to entitle them to depletion allowances. *Lynch v. Alworth-Stephens Co.*, 267 U. S. 364; *Palmer v. Bender*, 287 U. S. 551. As above indicated, Kohinoor neither owns, leases, nor has any other economic interest in a mineral deposit in place.

A case which is not only in point but on all fours with the present one is *Chicago Mines Co. v. Commissioner*, 164 F. 2d 785 (C. A. 10), certiorari denied, 333 U. S. 881.<sup>4</sup> There, as here, the taxpayer had no economic interest in any mine or other natural deposit, but had simply leased and reworked a refuse heap previously extracted from a mine owned by another taxpayer. There, as here, the taxpayer argued that the provisions of Section

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<sup>4</sup> The exactness of the parallel between the present case and the *Chicago Mines* case was recognized by both courts below and by the petitioner. (R. 9, 87-88; Pet. 14).

114(b)(4) of the Internal Revenue Code (Appendix, *infra*) broaden the meaning of the term "mines" in Section 23(m) to include culm or refuse banks.<sup>5</sup> There, as here, the taxpayer's petition for certiorari asserted that the decision of the Court of Appeals was inconsistent with the decisions of this Court in the *Herring*, *Douglas* and *Kirby* cases, *supra*, and in conflict with the decisions of the Court of Appeals for the Ninth Circuit in the *Kennedy* and *New Idria* cases, *supra*. There this Court denied certiorari; and there is no new circumstance here which would justify a different disposition.

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<sup>5</sup> Section 114(b) deals with the *basis* for depletion and does not come into play unless the taxpayer has an economic interest in a mine or natural deposit within the meaning of Section 23(m). Subsection (B) of Section 114(b) (4), added by Section 124 of the Revenue Act of 1943, simply defines "gross income from the property" to mean "gross income from mining" including in the term "mining" not merely extraction of the mineral from the ground but also the processes normally applied by mine owners or operators to make such mineral commercially marketable—in the case of coal, cleaning, breaking, sizing and loading for shipment. It is plain that Congress did not by this amendment intend to extend the benefits of Section 23(m) to every taxpayer engaged in such processing, regardless of whether he had any economic interest in a mine.

**CONCLUSION**

The decision of the court below is correct, and there is no conflict of decisions. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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May, 1949.

## APPENDIX

## Internal Revenue Code:

## SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

\* \* \* \* \*

(m) *Depletion*.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. \* \* \* In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. \* \* \*

\* \* \* \* \*

(26 U.S.C. 1946 ed., Sec. 23.)

## SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

\* \* \* \* \*

(b) *Basis for Depletion*.—

(1) *General rule*.—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

\* \* \* \* \*

(4) [as amended by Section 145 of the Revenue Act of 1942, c. 619, 56 Stat. 798,

and Section 124 of the Revenue Act of 1943, c. 63, 58 Stat. 21].—*Percentage depletion for coal \* \* \* mines \* \* \*.*—

(A) *In General.*—The allowance for depletion under section 23 (m) shall be, in the case of coal mines, 5 per centum \* \* \* of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23 (m) be less than it would be if computed without reference to this paragraph.

(B) *Definition of Gross Income From Property.*—As used in this paragraph the term “gross income from the property” means the gross income from mining. The term “mining”, as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term “ordinary treatment processes”, as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; \* \* \*

(26 U.S.C. 1946 ed., Sec. 114.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.23(m)-1. *Depletion of Mines, Oil and Gas Wells, Other Natural Deposits, and Timber; Depreciation of Improvements.*—Section 23 (m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest.

\* \* \* \* \*

When used in these sections (29.23(m)-1 to 29.23(m)-28, inclusive) covering depletion and depreciation—

\* \* \* \* \*

(b) A "mineral property" is the mineral deposit, the development and plant necessary for its extraction, and so much of the surface of the land only as is necessary for purposes of mineral extraction. The value of a mineral property is the combined value of its component parts.

(c) The term "mineral deposit" refers to minerals in place. The cost of a mineral deposit is that proportion of the total cost of the mineral property which the value of the deposit bears to the value of the property at the time of its purchase.

(d) "Minerals" include ores of the metals, coal \* \* \*.

\* \* \* \* \*